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## **Tommaso Padoa-Schioppa and economic thought and policy-making at the European Commission**

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# Tommaso Padoa-Schioppa and economic thought and policy-making at the European Commission

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## 1. INTRODUCTION

Tommaso Padoa-Schioppa (1940-2010) was a convinced European federalist. He was one of the great architects of the euro, the single currency. He is especially known as a rapporteur of the Delors Committee (1998-1999) and as a founding member of the Executive Board of the European Central Bank (1998-2005).

According to Jacques Delors, with whom he was very close, action, based on an exceptional wide and rich analysis was typical for Padoa-Schioppa, "La pensée et l'action. Telle est la réflexion première qui me vient à l'esprit lorsque j'évoque Tommaso Padoa-Schioppa. La pensée est assise sur une culture exceptionnelle allant de l'histoire à l'économie, sans oublier la science politique et donc l'art de gouverner et les exigences démocratiques" (Delors, 2011, 174).

Padoa-Schioppa was an economist by training. And while he always maintained strong links with the academic world, he was essentially a very influential policy-maker. Lorenzo Bini Smaghi, his successor in the Executive Board of the ECB, described Padoa-Schioppa's very rich and eclectic style of economics, "Tommaso defined himself as a 'practioner', a policy-maker, but his action was always deeply and unambiguously grounded in economic thought. ... he shared Keynes' view that practical men are often slaves of some defunct economist. Even in his early years as an economist, he identified those risks of enslavement and then sought to free himself from them by way of his life-long policy engagement: the dichotomy between general economic equilibrium theory and monetary theory; the dichotomy between *Nationalökonomie* and international economy; and the dichotomy between economic theory and institutions. He always aspired to bring these dichotomies to an end, by properly integrating the monetary, international and institutional dimensions into his assessment of economic policy" (Bini-Smaghi, 2011).

A crucial moment in the career of Padoa-Schioppa was his time as a Director-General for Economic and Financial Affairs at the European Commission, from June 1979 to March 1983. This period will be the focus of this paper. We first go into economic thought and policy-making at the European Commission and the situation of the European Community at the end of the 1970s. Thereafter we focus on the formation of Padoa-Schioppa and his activities at the Commission. A last section analyses the further career of Padoa-Schioppa as an architect of EMU.

## **2. ECONOMIC THOUGHT AND POLICY-MAKING AT THE EUROPEAN COMMISSION**

When studying economic thought and policy-making at the European Commission, one is confronted with the problem that the European Community is a very special construction, an entity "*sui generis*" as lawyers like to say. It is neither a federation, nor an intergovernmental organisation, but rather something between the two. The European Community is intergovernmental as changes in the Treaties governing the Community have to be approved by all countries, after an intergovernmental conference. However, within the areas designated in the Treaties, the Commission (its executive) can exercise sovereign powers. Moreover, it has the right of initiative to propose new Community legislation.

Macroeconomic policy-making in the European Community was mainly at the level of the Member States and so the responsibilities of the Commission<sup>1</sup> were rather limited. It is the College of the Commission which is ultimately responsible for policy-making at the European Commission. This concerned mainly the orientation and coordination of the national macroeconomic policies (Wegner, 1989). Over time, this coordination function of the Commission has increased in importance. With EMU, which started in January 1999, sovereignty in the field of monetary policy was transferred to the European Central Bank and the Commission's role in the coordination of macroeconomic policies was reinforced.

Inside the Commission, it is mainly the president and the member with the responsibility for DG II (Economic and Financial Affairs or ECFIN, which can be considered as the macroeconomic analysis and research department of the Commission) who are most involved in macroeconomic policy-making. When Padoa-Schioppa arrived at the Commission, in June 1979, Roy Jenkins (UK) was the president of the Commission, and François-Xavier Ortoli, a Frenchman, was responsible for DG II. From 1981 to 1984, Gaston Thorn, a Luxemburger, was president, while François-Xavier Ortoli remained responsible for DG II. According to witnesses, they were relatively easy-going people, who left the administration a lot of freedom. Ortoli was mostly interested in monetary matters.

The Director-Generals of DG II were typically Italians, with first two diplomats, Bobba and Mosca. From June 1979 to March 1983, Tommaso Padoa-Schioppa was Director-General of DG II. He was succeeded by Massimo Russo.

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<sup>1</sup> It can be useful to note that the term "Commission" is used both for the College of the Commission, the body of commissioners, and for the services of the commission, the administration. Also, every member of the Commission disposes of a small group of collaborators, his so-called "cabinet".

Macroeconomic thought at the Commission was, to a large extent, a synthesis and compromise of the main schools of macroeconomic thought in the European countries, especially the three big ones: Germany, France and the United Kingdom<sup>2</sup>.

German economic thought was centred around the social market economy. Two tendencies can be distinguished. The more free market oriented German economists would emphasise that economic policy was, in essence, "*Ordnungspolitik*", i.e. a policy to create a sound and secure framework within which markets can operate. The main tasks of economic policy are then: (a) monetary policy: assure price stability; (b) fiscal policy: rather limited task for the government, sound public finances are important; and (c) structural policy: competition policy is emphasised. The other tendency, more Keynesian, with Karl Schiller as an important representative, emphasised the social dimension of the "social market economy". It was linked to the social democrats and the trade unions and considered a dialogue between the social partners (trade unions and employers) as a crucial element of its strategy to stimulate growth and employment.

In general, German economists mostly emphasised that economic policy consisted in the application of certain basic economic principles (especially the respect of market mechanisms and wage moderation) to the actual policy challenges. It has certain similarities with Roy Harrod's characterisation of Keynes's view: "Following Marshall, he (= Keynes) believed... that progress in economics would be in the application of theory to practical problems. His recipe for the young economist was to know his Marshall thoroughly and read his Times every day carefully, without bothering too much about the large mass of contemporary publication in book form" (Harrod, 1951, 381).

Initially, French economic ideas were very influential at the Commission. Robert Marjolin, the first commissioner for DG II, had been the principal assistant to Monnet at the French Planning Office, famous for its five-year plans (Marjolin, 1986). The French Planning Office, while being part of the French "Colbertist" tradition, was also a spearhead of Keynesianism in France, with the national accounts at its heart (Rosanvallon, 1987, 40). Later, Malinvaud was influential, especially with his distinction between "Keynesian" and "classical" unemployment (Malinvaud, 1977).

Anglo-Saxon ideas in the post-war period followed different fads: Keynesianism, monetarism and supply-side economics. This was also so at the Commission, even if monetarism was less popular. From a methodological point of view, the Anglo-Saxons favoured generally a more analytical approach, whereby economic policy

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<sup>2</sup> For an overview of post-1945 economic thought in Europe, see the contributions in Coats, 2000.

recommendations would be based on more refined economic research. They especially favoured the developing of DG II's model building capacity.

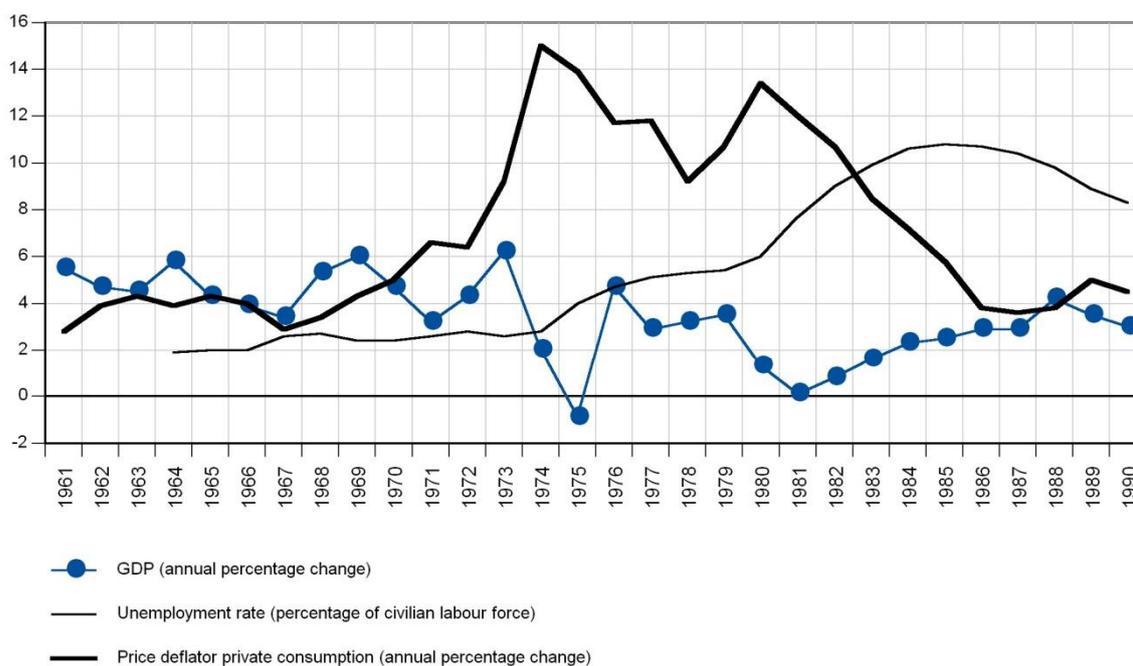
Initially, an important transmission channel for Anglo-Saxon ideas was the OECD. Many Commission officials, including Marjolin, had worked at the OECD and there were many interactions between the OECD and the Commission. Anglo-Saxon ideas received a big boost with the nomination of Padoa-Schioppa as director-general of DG II. Also, younger economists had a more Anglo-Saxon education, more of them having studied in the United States and having a Ph.D (Maes, 2000).

At the beginning of the 1980s, the Commission's analytical framework was medium-term oriented, with an important role for supply-side and structural elements (Maes, 1998, 14). The general view was probably best presented in the 1980 Annual Economic Report: "The concerted response to the present general economic situation should be based on the right strategic mix of demand and supply policies and notably the right balance in their application to short- and medium-term problems. Short-term adjustments should be more moderate than at times in the last decade, and a heavier weight has to be given to reducing medium-term inflationary expectations and improving supply conditions in the economy" (CEC, 1980, 13).

### **3. THE EUROPEAN COMMUNITY AT THE END OF THE 1970S**

The period from 1979 to 1983, when Padoa-Schioppa was Director-General of DG II, was not an easy period for the European Community. The European economy was coping with stagflation, after the oil shocks of the 1970s (see also Chart 1), while the European integration process was languishing. It was a period which was known as "Eurosclerosis".

**Chart 1: Economic growth, inflation and unemployment (EU12, 1961-1990)**



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Padoa-Schioppa himself, in his "General Report" on the activities of DG II during his time at the Commission, had a vivid description of the period, emphasising the return of national sovereignty, "La communauté, quant aux objectifs ultimes que lui ont assignés ses fondateurs, est sur la défensive depuis plusieurs années. Malgré les progrès réalisés, la simple affirmation des objectifs politiques ultimes n'est généralement tolérée que si elle prend la forme d'un appel rhétorique. L'intangibilité de la souveraineté nationale est redevenue un dogme. Ce dogme paralyse la Communauté dans sa vocation à la dynamique. Cette paralysie déforme la Communauté. Cette déformation est à son tour invoquée comme un argument supplémentaire contre le 'vieux' projet de l'intégration politique" (Padoa-Schioppa, 1983, 4). He further described how the Commission had lost its driving role in the process of European integration, "De la dynamique communautaire, la Commission a été conçue comme le moteur. En réalité, dans cette fonction, la Commission est un organisme gravement touché par le tournant de la deuxième moitié des années '60. Depuis, dans la plupart des cas, lorsque mouvement il y a eu, le moteur en était ailleurs: le Conseil européen, le duo Giscard-Schmidt, etc. La Commission est paralysée" (Padoa-Schioppa, 1983, 5)<sup>3</sup>.

<sup>3</sup> One might argue that this were rather pessimistic remarks. The Delors Commission was a clear counter example. Also, Giscard and Schmidt reinvigorated the integration process with the EMS.

In the second half of the 1970s, there were two important advances in European integration, albeit of a very different nature: the first direct elections for the European Parliament and the establishment of the European Monetary System, both in 1979.

The European Monetary System was very much an initiative of the French president Giscard d'Estaing and the German chancellor Helmut Schmidt (Ludlow, 1982). The EMS was launched against considerable scepticism, especially from academic economists but also from monetary experts who still had vivid memories of the "snake" unravelling. However, political leaders strongly pushed for the EMS and succeeded in getting it off the ground. The EMS was then a "victory of political intuition over expert opinion" (Mortensen, 1990, 28).

According to the 1978 Council Resolution, the European Monetary System was a "scheme for the creation of closer monetary cooperation leading to a zone of monetary stability in Europe". Monetary stability, the objective of the EMS, had a double dimension: internal and external. This was a compromise and synthesis between the ideas of the "monetarists", led by France, emphasising the importance of external stability (exchange rate stability) and of the "economists", led by Germany, advocating internal stability (price stability) and the coordination of economic policy (Maes, 2002).

The European Monetary System was composed of three main elements: the exchange rate mechanism (ERM), credit mechanisms and the European Currency Unit (or ECU).

At the core of the European Monetary System was the exchange rate mechanism. This may seem somewhat paradoxical, since not all currencies in the European Community participated. The original members were: the German mark, the Dutch guilder, the French franc, the Danish krone, the Belgian/Luxembourg franc, the Irish pound and the Italian lira. The British pound did not participate.

To bolster the credibility of the exchange rate mechanism, several credit mechanisms were foreseen: very short-term, short-term and medium-term, as well as the mechanism of Community loans. While the first two were central bank financing for currency support, the latter two offered balance of payment assistance linked to policy adjustment programmes.

The ECU was created. It was a basket currency comprising the currencies of the European Community, including those currencies that did not participate in the exchange rate mechanism. The original aim was for the ECU to play an important role in the functioning of the ERM, both as an indicator of the source of tensions in the foreign

exchange markets and as a means of settling central bank debts arising from currency support operations. However, this first aspect never took shape and the second was subject to restrictions. Instead, the ECU took on a significant role in the international financial markets, thanks also to the efforts of the Commission. It was an important project for Padoa-Schioppa.

The EMS agreement also specified a second institutional phase, with the creation of a European Monetary Fund, within two years of the start of the EMS. However, the functions of this Fund were never really agreed upon, and the plans were shelved in December 1980.

#### **4. THE FORMATION OF TOMMASO PADOA-SCHIOPPA**

Tommaso Padoa-Schioppa was born in 1940 in the Alpine town of Belluno in the Venezia region. He studied economics at the Bocconi University in Milan, one of the most prominent Italian universities.

He joined the Banca d'Italia in 1986. He made an early career at the research department, one of the leading policy oriented research institutes in Europe, with strong connections with prominent American and British universities (Porta, 1996, 180). The internationalisation of Italian economics was very much stimulated by the Bonaldo Stringher fellowships, awarded by the Banca d'Italia, from the 1930s onwards. Initially, the Italian fellows went mainly to Great Britain, especially Cambridge (Sraffa), Oxford and the LSE. From the 1960s and 1970s onwards, the fellows went increasingly to the United States, especially the Massachusetts Institute of Technology (Modigliani). Many of these fellows returned to the Banca d'Italia, contributing so further to the international links of the Bank of Italy (Maes, 2008).

At the beginning of the 1960s, under the governorship of Guido Carli, the Bank of Italy started with the construction of a macroeconomic model. Guido Rey became responsible for the real side of the model and Antonio Fazio for the monetary part. Rey went for a study visit to the Dutch Central Planning Bureau, where Tinbergen was the director. Fazio went to MIT, to study with Franco Modigliani, not only because he was an Italian and a famous monetary economist, but also for his experience with the creation of the FED-MIT model. In the mid-1960s, Franco Modigliani also became a consultant to the Bank of Italy, to advise it on building its econometric model (Modigliani, 1999).

So, the Banca d'Italia maintained strong international academic connections and played a leading role in the modernisation of economics, not only in Italy but also in the world of the (European) central banks. It is further noteworthy that, in the 1960s and early 1970s, most

of the international contacts of the Bank of Italy were with "moderate Keynesians", like Hicks, Samuelson, Modigliani, Klein or Tobin (Ciocca 2004, p. 592).

Also Padoa-Schioppa was strongly embedded in this Anglo-Saxon economics tradition. Not only was Bocconi one of the most internationally orientated universities in Italy. He was also a student and, later, a visiting scholar at the MIT. He was close to Franco Modigliani: they published together (Modigliani and Padoa-Schioppa, 1978) and he contributed to Modigliani's Festschrift (Padoa-Schioppa, 1987).

In the second half of the 1970s, Padoa-Schioppa was seconded from the Bank of Italy to the Treasury, where Filippo Pandolfi was Treasury Minister. He wrote there an economic adjustment programme, which became known as the Pandolfi plan. So, Padoa-Schioppa gained important insights in the economic policy-making process in Italy. Moreover, when the position of Director-General for Economic and Financial Matters at the European Commission became vacant, Pandolfi pushed for the nomination of Padoa-Schioppa.

## **5. TOMMASO PADOA-SCHIOPPA AS DIRECTOR-GENERAL OF DG II**

Padoa-Schioppa had a profound impact on DG II. According to witnesses, he was not only a skilful administrator, but also a brilliant economist and very well connected. He combined a German rigor<sup>4</sup> with Italian imagination and a profound economic culture, including mainstream Anglo-Saxon economics. He was then quite young (not yet 40 when he arrived), dynamic and rather ambitious.

His main focus of attention at the European Commission was the reinforcement of the European Monetary System, which he considered as the "priority of the priorities". As he observed on the EMS in his "General Report", "son démarrage en 1979, son bon fonctionnement ensuite, son approfondissement en 1982, ont constitué la priorité des priorités, et j'y ai consacré une grande partie de mon temps. Mais ce champ recouvre aussi le développement spectaculaire du circuit privé de l'écu, les tentatives d'améliorer la coopération monétaire internationale et de progresser dans l'intégration financière européenne. S'il fallait caractériser par un seul thème le temps de mon service à la DG II, je choisirais le SME" (Padoa-Schioppa, 1983, 12-13). His other main preoccupation was the strengthening of the analytical level of DG II.

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<sup>4</sup> He was known for being very strict on the time accorded for an appointment, for instance, from 19h20 to 19h28.

## 5.1. THE STRENGTHENING OF THE EMS

As mentioned, Padoa-Schioppa arrived at the European Commission in June 1979, less than three months after the start of the EMS on 13 March 1979<sup>5</sup>. The first priority of Padoa-Schioppa was to avoid that the EMS would become a repetition of the snake, which was characterised not only by realignments, but also by several countries leaving the snake. Moreover, decisions about this were very much national decisions, not Community decisions. Furthermore, the snake did not really contribute to policy convergence.

Another crucial priority of Padoa-Schioppa was to strengthen the position of the Commission in the management of the EMS, which was very much in the hands of the central banks<sup>6</sup>. He therefore reinforced the Monetary Directorate of DG II. He created an EMS desk, so that the Commission had the necessary information on the functioning of the EMS. DG II also developed a "Manual" with all the procedures and timing for a realignment.

**Table 1 - An overview of the functioning of the exchange rate mechanism of the EMS**  
(March 1979 - January 1987, normal fluctuation margin of 2.25 %)

Date	DEM	NLG	FRF	DKK	BEF/ LUF	IEP	ITL
13.03.79	Start	Start	Start	Start	Start	Start	Start <sup>1</sup>
24.09.79	+2.0			-2.9			
30.11.79				-4.8			
23.03.81							-6.0
05.10.81	+5.5	+5.5	-3.0				-3.0
22.02.82				-3.0	-8.5		
14.06.82	+4.25	+4.25	-5.75				-2.75
21.03.83	+5.5	+3.5	-2.5	+2.5	+1.5	-3.5	-2.5
22.07.85	+2.0	+2.0	+2.0	+2.0	+2.0	+2.0	-6.0
06.04.86	+3.0	+3.0	-3.0	+1.0	+1.0		
04.08.86						-8.0	
12.01.87	+3.0	+3.0			+2.0		

<sup>1</sup> Fluctuation margin of 6 %.

<sup>5</sup> The start was foreseen for 1 January, but was delayed due to disagreements on the effects on the EMS on the Common Agricultural Policy.

<sup>6</sup> For an analysis of how the Commission tried to increase its role in monetary matters in the 1960s (and its relations with the central banks), see Maes, 2006.

Over time, the realignments in the EMS became more collective decisions. Padoa-Schioppa (1985) tells the story of the first realignments, "The first one took place in September 1979, less than six months after the System had started. I remember vividly that the Secretary of State of the German Ministry of Finance - it was Mr. Lahnstein at the time - came to the realignment session with a list of what the new parities were to be, saying: 'We have thought about the situation and have come to the conclusion that the following parity changes have to be made'. The session was rather difficult. It succeeded in setting new parities, which were in the direction indicated by that list, but not identical. It was clear to all that the next realignment would have to be made differently. At the first meeting of the Monetary Committee after the realignment, Mr. Lahnstein himself expressed the view that the Commission should propose the new parity grid on the next occasion. In a sense, this episode can be seen as the switch from the 1972 agreement on exchange rates (the so-called Snake) to the EMS".

The second and the third realignments, however, were not really collective, but unilateral decisions on devaluations of the Danish crown and Italian lira. Moreover, the Commission was not part of the central bank consultations on the Danish devaluation of 30 November 1979. In the following meeting of the Committee of Governors, Ortoli complained that the Commission had only been consulted late, "En ce qui concerne la procédure qui a été appliquée lors de la dévaluation de la couronne, s'il est heureux que des consultations aient eu lieu entre les banques centrales, il est regrettable que la Commission ait été consultée tardivement. En effet, la Commission est responsable de la gestion du système agromonétaire et les réalignements ne restent pas sans conséquence sur ce système (notamment les montants compensatoires). Les procédures suivies pour les réalignements devraient donc être réexaminées" (Minutes of the 140th Meeting of the EEC Committee of Governors, 11 December 1979, NBBA)<sup>7</sup>.

Padoa-Schioppa (1985) aptly summarised the change in the situation, "Thus, what can be called the hegemonic method was abandoned after the first realignment and the unilateral method typical of Bretton Woods after the third. Since then, all the realignments haven been made properly, in the sense that on each occasion there was a meeting at the Community level, with the realignment being decided only after all the member countries had had an opportunity to propose a change in parities alternative to that asked for by the applicant country".

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<sup>7</sup> It is noteworthy that Ortoli, from June 1979 onwards, became more active in the meetings of the Committee of Governors.

In the autumn of 1979, Padoa-Schioppa was also very much involved in Commission proposals to strengthen economic policy coordination<sup>8</sup>. A crucial element were preliminary consultations on monetary policy. Ortoli, at the November meeting of the Committee of Governors, announced the new Commission document and its main ideas, "Monsieur Ortoli signale que la Commission, en exécution d'un mandat d'examiner les possibilités d'améliorer la coordination des politiques économiques, envisage de présenter prochainement au Conseil des Ministres un document qui suggérera une procédure beaucoup plus précise qu'actuellement pour les grandes décisions nationales en matière de politiques monétaires et, en particulier, de politiques de taux d'intérêt. Cette procédure, qui toucherait le fonctionnement des Comités, s'inspire de l'idée que les décisions de politique monétaire, notamment dans le cas d'un grand pays, ne restent pas sans influence sur l'évolution à l'intérieur du SME et que par conséquent de telles décisions devraient être soumises à une consultation préalable à haut niveau... De la sorte, tout en respectant la responsabilité nationale en matière de politique monétaire, les préoccupations communautaires seraient de plus en plus prises en considération, ce qui est indispensable, car, sans une meilleure coordination des politiques monétaires, le fonctionnement du SME serait mis en péril" (Minutes of the 139th Meeting of the EEC Committee of Governors, 13 November 1979, NBBA). The first reaction was from Otmar Emminger, the President of the Bundesbank, "Monsieur Emminger constate qu'on tend à mettre en relief uniquement les mesures de la politique monétaire allemande tandis qu'on passe sous silence le fait que d'autres autorités de la Communauté ont pris, au cours des derniers mois, des mesures également sans consultation préalable" (Minutes of the 139th Meeting of the EEC Committee of Governors, 13 November 1979, NBBA).

In the following months the Commission proposal was analysed by the central banks. In the meeting of January 1980, the alternates of the Governors reported on their discussions, "les Suppléants sont d'avis que les consultations préalables sur les politiques monétaires sont souhaitables mais qu'en pratique elles peuvent être difficiles, voire impossibles, étant donné la variété, au sein de la CEE, des procédures et des structures qui sont mises en jeu pour prendre les décisions. ... Toutefois, quelques Suppléants ont souligné que la politique monétaire étant définie dans la plupart des pays en termes d'objectifs quantitatifs officiels, des consultations préalables pourraient avoir lieu sur la fixation des objectifs" (Minutes of the 141th Meeting of the EEC Committee of Governors, 8 January 1980, NBBA). During the meeting, Karl-Otto Pöhl, the new president of the Bundesbank, insisted that the Commission should inform the Council of Ministers of the reservations of the central bank governors concerning preliminary consultations with respect to monetary policy decisions, "Monsieur Pöhl pense néanmoins que la Commission devrait informer le Conseil des réserves qui ont été formulées au sein du

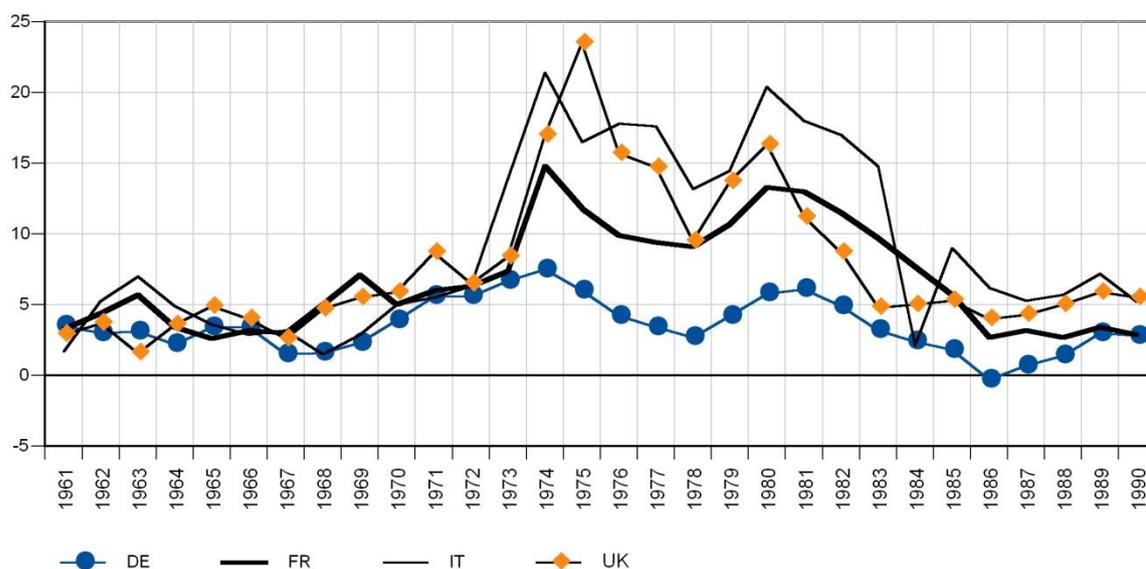
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<sup>8</sup> Economic policy coordination was also a topic of the November 1979 Dublin European summit.

Comité à l'égard d'une obligation de consultation préalable pour toute décision d'une politique monétaire et de crédit" (Minutes of the 141th Meeting of the EEC Committee of Governors, 8 January 1980, NBBA).

The early 1980s were a difficult time for the EMS, with tensions on the foreign exchange markets and several realignments (see Table 1). In order to stabilise the EMS, convergence of economic policies was crucial. The realignments turned out to be important moments in the convergence process (Padoa-Schioppa, 1983b). As already mentioned, contrary to earlier practice, when devaluations or revaluations were unilateral decisions, the realignments became collective decisions (mostly with meetings of the Ecofin Council). Padoa-Schioppa further succeeded in developing the role of the Commission in the accompanying adjustment policies, of crucial importance for the convergence process. As observed in the 1982 Commission analysis of the EMS, "At each of the last two realignments, the countries most affected agreed to implement accompanying policies which would enhance the beneficial effects and neutralize the perverse effects of the changes in parity. In Belgium, the February devaluation was an integral part of a recovery plan designed to resolve the structural problems in the economy... The June realignment is also indicative of a concern to establish greater convergence. In the countries whose currencies were devalued, stabilization policies are now being applied... The Commission has for its part actively encouraged the process of convergence. It has not confined itself simply to following through as effectively as possible the coordination procedures for economic policies provided for in Community texts. It has tried to spell out what convergence should mean in practice" (CEC, 1982, 36). While there was a worldwide tendency towards stability oriented policies, the EMS would play a significant role in policy adjustment and inflation convergence in the European Community in the 1980s (see Chart 2).

Chart 2: Inflation



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Of special importance hereby was the situation in France, as the EMS was the "baby" of Giscard. A crucial problem for Padoa-Schioppa, was the "adoption" of the EMS by Mitterrand, who had become French President in May 1981, with a socialist-communist government. He worked hereby closely with Ortolí, his Commissioner, Delors, who had become French Finance Minister and Andreatta, the Italian Finance Minister. It was known as the "Delors - Andreatta - Ortolí – Padoa-Schioppa plot". The realignment of March 1983 is generally considered as the turning point in the EMS, with a significant change in French economic policy, the famous "politique de rigueur".

As mentioned earlier, the EMS agreement also specified a second institutional phase, with the creation of a European Monetary Fund within two years of the start of the EMS. This was an important dossier for Padoa-Schioppa, in which he was very much involved himself.

The Commission developed proposals for this second institutional phase of the EMS, focussing on the creation of a European Monetary Fund, a furthering of the ECU and a strengthening of the external aspects of the EMS. However, the negotiations did not really take off and the plans were shelved in December 1980. Padoa-Schioppa, in his "General Report", was very sharp on this episode, singling out especially the resistance of Germany and the Bundesbank for this failure, "Il y a de multiples raisons à cela: le deuxième choc

pétrolier, la nouvelle flambée inflationniste qui l'a suivi, l'envol du dollar, les tensions centrifuges consécutives à ces développements. Mais la raison essentielle a été, d'une façon générale, la méfiance affichée au fond, et parfois en public, par les autorités monétaires du pays ayant la monnaie la plus forte. Une opinion publique qui n'était déjà pas très favorable au système, a été flattée dans ses sentiments anti-SME par l'autorité même chargée de sa gestion". He considered 1982, a year of severe turmoil in the exchange rate mechanism, as a turning point, "Cette attitude a changé quand, en mai 1982, l'existence du système a été en danger. Il a alors été compris que l'enjeu était d'abord économique et commercial, avant d'être monétaire, et que le SME n'avait jamais vraiment affaibli la défense de la stabilité monétaire. Il était trop tard pour faire aboutir l'initiative de l'approfondissement. C'est grâce à la sagesse de la France et des autres pays membres du système, que le scepticisme allemand n'a pas été fatal" (Padoa-Schioppa, 1983, 30).

Padoa-Schioppa then sought other ways to strengthen the EMS. These efforts culminated in the proposals of the European Commission, of March 1982, for a "non-institutional" development of the EMS. There were several, rather technical, ideas. A first element was to strengthen the position of the ECU and the exchange rate mechanism, for instance by increasing the negotiability of the ECU, by increasing the use of Community currencies for intra-marginal interventions and by coordination of relations vis-à-vis the dollar. Secondly, the Commission proposed to open the system towards the outside world by permitting third country monetary authorities to hold and use the ECU. Thirdly, there was a chapter on encouraging the use of the ECU on the financial markets, for instance, by increasing the ECU borrowing and lending activity of Community institutions and by minimizing restrictions on the use of the ECU. It would become a cherished topic for Padoa-Schioppa. A fourth dimension was a reinforcement of policy convergence, stressing the full utilization of the existing framework and improving follow-up measures.

But the Commission not only proposed technical improvements for the EMS, it also elaborated proposals with a more political content. These focused on the full participation of all currencies in the exchange rate mechanism and the issue of an ECU coin. Of crucial importance for the Commission was the participation of all EU currencies. As stressed by the Commission, "The European Monetary System will not assume its full significance and will not achieve its full potential until it organizes, on an equal footing, the exchange rate relationships of all the Community currencies: sterling's, and later the drachma's, participation in the exchange rate mechanism (and the narrowing to 2,25 % of the Italian lira's present margins) would bring the system to full fruition and would act as a signal to the markets and to public opinion of the determination to pursue in common the attempt - accepted and recognized by all - to establish a zone of monetary stability in

Europe" (CEC, 1982, 52). The Commission further defended the idea of an ECU coin, which would circulate freely throughout the Community. This should strike public opinion by "bringing the ECU out of the specialists' circle (central banks, exchange dealers, capital market operators) to which it is now confined, and putting it in the pocket of the man in the street, the ECU's destiny as the monetary symbol of the Community would be fully affirmed" (CEC, 1982, 52).

Typical for Padoa-Schioppa was that he always took a long-term perspective. One of the issues which he was also aiming for was progress in financial integration (which had dropped out of the monetary discussions at the end of the 1970s, the beginning of the EMS, cf. Maes, 2007). Padoa-Schioppa became also very much focussed on the long-term consequences of a stable EMS and financial integration. In a lecture in Milan in June 1982, he coined his famous "inconsistent quartet", the impossibility of reconciling (1) free trade, (2) full capital mobility, (3) fixed (or at any rate managed) exchange rates and (4) national autonomy of monetary policy. As Padoa-Schioppa (1982) observed, he was enlarging the "inconsistent trinity" of international monetary theory: "The incompatibility between fixed exchange rates, free capital movements, and independent national monetary policies has been referred to in economic literature as the 'inconsistent trinity'. I have turned this trio into the 'inconsistent quartet' by adding a fourth element, free trade, which is a pillar of the Treaty of Rome and an aspect which cannot simply be taken for granted in our present economic environment". The inconsistent quartet would become very popular in the second half of the 1980s, when exchange rates were stable in the EMS and the European Community embarked on the single market project, when capital controls were lifted and the remaining non-tariff barriers in the trade of goods and services were removed (Padoa-Schioppa, 1988). What is crucial is that for Padoa-Schioppa there was a strong link between a single market and monetary integration. It was his profound conviction that the European single market would not survive without a single currency.

Furthermore, Padoa-Schioppa was also very actively involved in the promotion of the ECU as a "parallel currency". For instance, he played an important role in the development of the ECU clearing system. Padoa-Schioppa (1987b) tells that, "In February 1982, prompted by Robert Triffin and Paul Caron, I convened the banks that were then active in the ECU market and invited them to set up a study group for the creation of a multilateral clearing system". During the mid 1980s, Padoa-Schioppa pushed further for a parallel currency approach. Padoa-Schioppa (1985) hailed the "unforeseen growth of the ECU in private markets" as an important success, "What is important is that they show that there is considerable potential for an international currency used by private agents,

and that the development of this potential only requires a very small legal, and one could say 'official', platform"<sup>9</sup>.

In his "General Report", of February 1983, Padoa-Schioppa gave a mixed picture of the situation of the EMS at the time of his departure from the Commission. There was important progress, but there were also significant shortcomings, "Le SME s'est sensiblement renforcé par l'obtention, petit à petit, de deux résultats importants qui n'étaient pas acquis d'avance: i) les modifications de parités sont véritablement devenues des décisions collectives, beaucoup plus que ce n'était le cas dans le système de Bretton Woods; ii) il est devenu de règle que les changements de parités soient accompagnés par des mesures de politique économique... Les approfondissements du système "dans" l'acquis sont importants, mais non irréversibles. Il faut les consolider, et une telle consolidation ne sera durable que s'il y a extension "de" l'acquis. Pour cela, nos propositions de mars 1982 ne représentaient qu'un petit pas. Le chemin vers l'union monétaire est encore long" (Padoa-Schioppa, 1983, 13).

## 5.2. STRENGTHENING THE ANALYTICAL CAPACITY OF DG II

Padoa-Schioppa was very well aware that the powers of the Commission in the area of macroeconomic policy-making were limited. Its main function was contributing to the coordination and orientation of the policies of the Member States. Like for other international institutions, persuasion was crucial. As observed by Coats (1986, 167), "skills in communication and the art of persuasion are generally at a premium in international agencies, given their limited powers". To have an impact inside a multinational (and multilingual) organisation, communication and negotiation skills are more important than in national organisations<sup>10</sup>. Padoa-Schioppa stressed further that two elements were crucial for the Commission: professionalism and "telling the truth", "Le véritable instrument est la persuasion, les normes de base ne pouvant en aucun cas remplacer la qualité de l'argumentation. Si, dans ces domaines "non opérationnels", l'action est celle des autres, la Commission dispose néanmoins, pour persuader, de deux instruments: la professionnalité et la possibilité de "dire la vérité" (Padoa-Schioppa, 1983, 7).

Padoa-Schioppa was also very much aware, from his former experience at the Banca d'Italia, that the reputation of the Commission in terms of economic analysis was not so strong, "Je savais, pour avoir été fonctionnaire national, que les documents, les analyses

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<sup>9</sup> The turning point for Padoa-Schioppa was the Delors Report, which rejected the parallel currency approach.

<sup>10</sup> As also remarked by Delors, cf. Hay, 1989, 17. Marris' remarks about the OECD apply also to the European Commission: "good economics" merges almost imperceptibly into the art of persuasion', (Marris, 1986, 113).

et les prises de position de la Commission en matière de politique économique et monétaire n'attiraient pas la même attention et ne jouissaient pas du même prestige que celles d'autres organismes internationaux. Les documents de la Commission avaient la réputation d'être trop nombreux, souvent inexacts, analytiquement pauvres et peu originaux. J'ai consacré une partie très importante de mon temps à une action sur les instruments et les méthodes de travail dans le but de réduire, et si possible de combler, le "retard", de la DG II en matière d'analyse et de politique économique" (Padoa-Schioppa, 1983, 14).

A crucial objective for Padoa-Schioppa was then a strengthening of the analytical capacity of DG II, "Un effort particulier pour élever la capacité d'analyse économique de la DG II a été accompli, en agissant sur deux éléments que j'appellerais "intelligence" et "modèles d'excellence". Par "intelligence" j'entends l'élément de capacité d'analyse économique qui entre, ou devrait entrer, dans une très grande partie des travaux de la DG II; par "modèles d'excellence" les opérations, les papiers, les études, ou les publications dans lesquels on essaie d'atteindre un niveau de qualité particulièrement élevé, avec pour objectif d'obtenir non seulement un résultat de haute qualité, utile en soi, mais aussi d'exercer un effet d'entraînement, d'imitation, sur les méthodes à appliquer et les résultats à atteindre dans d'autres domaines" (Padoa-Schioppa, 1983, 15).

An important element in his strategy was a reorganisation of DG II, in March 1980, with at its core a new directorate, Macroeconomic Research and Policy. After this reorganisation, DG II consisted of four directorates:

- the A Directorate: National Economies. The A Directorate was responsible for monitoring and analysing the economic situation on a vertical basis, country by country. It consisted of four divisions, three of them followed the different countries of the Community, the fourth the rest of the world;
- the B Directorate: Economic Structures and Community Policies, can be considered as a kind of "economic service", where the various policies of the Community (sectoral, industrial, competition...) were followed and analysed;
- the C Directorate: Macroeconomic Research and Policy. This was a newly founded directorate, which reflected a double aim. The methodological purpose was to pursue more academic oriented research, as clearly indicated in the word Research in the name of the new directorate. The other purpose was to focus on macroeconomic policy for the European economy as a whole. This also reflected the idea that the Commission could have more influence on economic policies in the member states if it

could highlight the Community dimension of a certain national policy stance. The director of the C directorate was usually the main author of the Annual Economic Report, the most important macroeconomic policy document of the Commission. The directorate consisted of five units: concerted action (a newly created division, responsible for a 'horizontal' analysis of the Community economy and for policy actions at the Community level); short-term forecasts (responsible for the coordination and consistency of the forecasting exercises); business cycle surveys (responsible for the coordination and aggregation of business and consumer surveys, which were executed by different institutes in the Member States); medium-term forecasts; econometric models (a newly created division, the purpose was to give DG II more autonomy in econometric modelling, like at the Bank of Italy. This group would later be merged with the unit for medium-term forecasts);

- the D directorate: Monetary Matters. It consisted of four divisions, focusing on the EMS, the balance of payments situations, monetary policy in the different countries, and capital markets.

Also other reforms contributed to the strengthening of the intellectual and analytical capacities of DG II, like the organisation of seminars (both by DG II economists and outsiders) and the reinvigoration of the group of advisers (economists, both academics and national policy-makers, who were on a temporary basis at the Commission). Padoa-Schioppa also launched a new series of publications, the "Economic Papers" (which were the sole responsibility of the author). This caused quite a stir in the Commission, as officials publishing in their own name in an official publication of the European Commission was a completely new phenomenon for the Commission.

Of particular importance was the collaboration with the Centre for European Policy Studies (CEPS), located in Brussels, especially with the foundation (and funding by DG II, cf. Ludlow, 1983, 2) of the CEPS Macroeconomic Policy Group<sup>11</sup>. This Group was also known as the Dornbusch Group, after its first Chairman.

DG II economists would have meetings with the members of the CEPS group, in which the macroeconomic situation and the policy challenges for the European Community would be discussed. The CEPS economists would offer their comments on policy documents of the Commission, especially the Annual Economic Report, and they would also, every year, write their own paper. Initially, the Dornbusch Group was set up as an internal advice group. Later, under the pushing of the academics, it was decided to

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<sup>11</sup> Padoa-Schioppa also presented a paper at the CEPS opening conference, cf. Padoa-Schioppa and Papadia, 1983.

publish the papers of the Dornbusch Group, both as a CEPS paper and as an Economic Paper of the Commission.

This triangular collaboration (Dornbusch Group, Commission, CEPS) offered DG II several advantages: it strengthened the analytical and intellectual level of the economic policy debate, it allowed the Commission to penetrate into the world of the economic intelligentsia, and it exposed the services of DG II to emulation and contradiction. Moreover, it was also a way to let top American academics get to know the European Community and to analyse Europe's economic problems.

The Economic Papers of the Dornbusch Group would cause quite some turmoil, especially in the cabinets but also among the Commissioners. Several people asked the question why the Commission should pay people "who make our life difficult". Senior DG II officials, like Padoa-Schioppa and Emerson, defended the principle of publishing the work of the Dornbusch Group. They argued that the cooperation with the Dornbusch Group was very important for DG II, both for improving its analytical capacity and for increasing its influence in the academic world. Consequently, one had to "accept the rules of the game" and let the Dornbusch Group publish the results of its research. They were herein supported by Ortolì, the Member of the Commission responsible for DG II.

As mentioned earlier, in the early 1980s, the European economy was coping with a serious stagflation, after the second oil shock of 1979 and high US interest rates. In its analysis, the Commission strongly emphasised the structural aspects of the crisis: "the accumulated back-log of adjustments and on our growing incapacity to respond quickly to the recent changes in the economic environment. The increased structural rigidities in our economies and social behaviour have changed profoundly the long-term dynamics of the business cycle" (CEC, 1982, 11).

In the 1980s, unemployment more and more dominated the economic scene. Unemployment would become the main theme of the debate between the Commission and the CEPS Macroeconomic Policy group. The CEPS group, consisting mostly of "sophisticated Keynesians", many with an American background, argued for a more reflationary fiscal policy. Their position was elaborated in a report: "Macroeconomic Prospects and Policies for the European Community" of April 1983, by G. Basevi, O. Blanchard, W. Buiter, R. Dornbusch and R. Layard. The Group argued that there was no evidence that "unemployment is all and without exception, or even predominantly, a real wage problem" (Basevi et al., 1983, 3). They favoured a coordinated expansionary policy, accompanied by incomes policy.

In its analysis of the unemployment problem, the Commission strongly emphasised that economic growth had become less labour-intensive. According to Commission estimates the stock of capital per employed person had risen at an average annual rate of 2.5 % in the preceding decade (CEC, 1984a, 24). The rise in relative labour costs, which was at the origin of this capital deepening, was not only the consequence of increases in nominal wages but also of the rise of non-wage labour costs. Substitution was further stimulated as the cost of capital was kept low, partly due to fiscal advantages. For the Commission, the increase of public expenditure, as well as the structure of expenditures and taxes, was one of the causes of the increase in unemployment.

Another reason for the increase in classical unemployment, according to the Commission, were the growing rigidities in the labour markets in Europe. They were the result both of legislation and of collective agreements. These were generally introduced in the golden sixties, in order to protect weaker groups. However, the Commission noted that: "Some of these regulations have proved to be ill-adapted to new circumstances and may ... have hindered employment creation" (CEC, 1984a, 33).

The employment strategies, proposed in the Annual Economic Reports of 1982, 1983 and 1984, were very broadly based and comprised: (a) a stable macroeconomic framework; (b) an improvement of the competitiveness of the enterprise sector, especially the strengthening of the internal market; and (c) measures concerning the labour market, including wage moderation, more differentiated wage settlements and a "systematic reappraisal of labour market regulations and conventions" (CEC, 1984a, 34).

In a certain sense this debate can seem somewhat paradoxical: it was the policy-makers at the European Commission who were defending the "new" paradigm of supply-side economics, while the academics were in favour of the "old" Keynesian paradigm. It certainly shows that policy-makers can be open to new economic theories. It is also a clear indication that DG II, under the leadership of Padoa-Schioppa, in the early 1980s was very alert to what was happening in the academic world and integrating this into its analysis of the economic situation in Europe. Moreover, the Commission had just had a very bad, if not traumatic, experience with a coordinated Keynesian demand expansion. The "concerted action", after the European Summit in Bremen and the G7 Summit in Bonn in 1979, led to an increase in inflation and balance-of-payments deficits in the early 1980s (Maes, 1998, 404). It led European Commission officials to focus on the supply side, especially the increased rigidities in Europe's labour markets. These rigidities made Europe certainly different from the United States, with its flexible markets, where many of the members of CEPS Group lived.

## **6. THE LATER CAREER OF PADOA-SCHIOPPA AS AN ARCHITECT OF EMU**

For Tommaso Padoa-Schioppa, becoming director-general of DG II, became a defining moment in his career and his life. He became immersed in several European networks, which would be of enormous importance for his further career.

In Brussels he got an inside view of the functioning of the European Commission and established relations and friendships with many members of the Commission and officials, in first instance François-Xavier Ortoli, the member of the Commission responsible for DG II. Moreover, Ortoli introduced him to Jacques Delors, who was then chairman of the economic and monetary committee of the European parliament. The two, sharing a profound European conviction and a visionary long-term approach, immediately became close friends. Padoa-Schioppa would, de facto, become Delors' trusted advisor on monetary and financial matters, on whom Delors would call in difficult and decisive moments.

As director-general of DG II, Padoa-Schioppa also participated in several important meetings, like those of the Ecofin Council and the Monetary Committee, giving him further inside knowledge of the functioning of the EU institutions and enlarging his networks. Of particular importance was his participation in the meetings of the Committee of Governors of EEC central banks. Ortoli, as the member of the Commission responsible for Monetary and Financial Matters, participated in the meetings of the Committee of Governors and Padoa-Schioppa was his alternate. So Padoa-Schioppa acquired a profound knowledge of the functioning of the central banks in the Community at the highest level. It would become a very valuable asset in his further career and in his projects at European monetary integration. It made him, for Delors, a natural rapporteur for the "Delors Committee".

After his stay in Brussels, Padoa-Schioppa returned to the Banca d'Italia. When Delors became president of the Commission, he relaunched the process of European integration with the internal market programme. He also requested a report by a study group, chaired by Padoa-Schioppa, on the implications of the internal market for the future of the Community (Padoa-Schioppa, 1987). It contained a warning that the liberation of capital movements was inconsistent with the prevalent combination of exchange rate stability and national autonomy of monetary policy.

EMU came back on the agenda at the Hanover meeting of the European Council on 27 and 28 June 1988. It confirmed the objective of economic and monetary union and decided to entrust to a Committee the task of studying and proposing concrete stages

leading towards this union. The Committee was chaired by Jacques Delors, who had the confidence of Kohl and Mitterand, and, as a former finance minister, the technical expertise. The governors of the central banks - in a personal capacity - were also on the Committee. Delors wanted them to be members, both because of their technical expertise and because this would bind them to the monetary union project. The Committee produced its report for the June 1989 meeting of the European Council (Committee for the Study of Economic and Monetary Union, 1989, hereafter referred to as the Delors Report). Padoa-Schioppa, together with Gunter Baer, became rapporteur of the Committee. In this way he had a very influential role, especially in the drafting of the report.

The Delors Report would assume a crucial role as a reference and anchor point in further discussions and negotiations on EMU, just as the Werner Report nearly two decades earlier. It would very much become the basis for the chapters on EMU in the Maastricht Treaty. Padoa-Schioppa played further an influential (behind the scenes) role in later negotiations, especially through his contacts with Delors and with the Italian delegation. So was he a Special Advisor to the Guigou Committee (from June 1989 to October 1989), which prepared the questions to be addressed in the Intergovernmental Conference. He was also, together with Umberto Vattani (Prime Minister Andreotti's diplomatic advisor) and Mario Draghi (then Director-General of the Treasury), one of the three key Italian officials involved in the Intergovernmental conference, the so-called "Gang of Three" (Dyson and Featherstone, 1999, 495). One of Padoa-Schioppa's suggestions was the fixed date for the start of the third phase of EMU.

In June 1999, Padoa-Schioppa became a member of the first Executive Board of the European Central Bank. It was a coronation for his work and efforts for the creation of Economic and Monetary Union.

## **7. CONCLUSION**

Tommaso Padoa-Schioppa was one of the great architects of the euro. He is especially known as a rapporteur of the Delors Committee and as a founding member of the Executive Board of the European Central Bank. He studied economics at the Bocconi University in Milan and at the Massachusetts Institute of Technology (with Modigliani). He was so well formed in mainstream Anglo-Saxon economics. He started his professional career at the Research Department of the Bank of Italy.

For Tommaso Padoa-Schioppa, becoming director-general of DG II at the European Commission (from 1979 to 1983), became a defining moment in his career and life. At the Commission, his main priority was the European Monetary System, which was established in March 1979. The early years of the EMS were difficult, with tensions on the

exchange markets, several realignments and the shelving of the plans for a second institutional phase. Padoa-Schioppa was very much involved in several projects to strengthen the EMS and to improve economic policy convergence. Moreover, he tried to strengthen the position of the ECU and to relaunch European financial integration. The most forceful exposition of his ideas was probably the inconsistent quartet, stating that the combination of free trade, free capital movement, independent monetary policies and fixed exchange rates was not sustainable.

The other main objective of Padoa-Schioppa, as director-general of DG II, was the strengthening of its analytical capacity. Coming from the Bank of Italy, and with strong contacts with the Anglo-Saxon academic world, Padoa-Schioppa sought to strengthen DG II's model building capacity and its links with the academic world. As such he played a crucial role in the professionalisation of economics at the European Commission.

At the Commission, Padoa-Schioppa became also immersed in several European networks. Of crucial importance hereby were his contacts with Jacques Delors. This would be of enormous importance for his further career, becoming one of the architects of the single currency.

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